

# **Thriving in a Hostile Environment: Fairtrade's Role as a Positive Market Mechanism for Disadvantaged Producers**

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## **Introduction**

Consumers clearly like Fairtrade. Sales of Fairtrade products in Europe, North America, and Japan have grown exponentially in recent years; Fairtrade bananas have a 50 per cent market share in Switzerland (AgroFair, 2004), and global sales of all Fairtrade products amounted to approximately £500m in 2003 (Vidal, 2004) up from an estimated £335m in 2002 (Leatherhead Food International, 2003). Fairtrade coffee is the fastest-growing segment of the speciality coffee industry in the US and UK (McCarthy, 2004). The UK market in 2004 was worth about £130m. To date, these figures include the initially small, but rapidly growing, US market. If US market development follows the pattern of European markets – and there is evidence to believe that it may be moving even faster – global sales of Fairtrade will increase by a factor of 10-15 in the next few years. Therefore, it is far from fanciful to assume that global Fairtrade sales will top £1b by 2007 (Demetriou, 2003).

## **What is Fairtrade?**

Fairtrade represents a market-driven response to trade inefficiencies and inequalities. By redefining purchase utility in terms of a holistic view of the supply chain – specifically by reconnecting producer and consumer interests – Fairtrade has positioned trade justice as a premium brand value for many customers. Fairtrade is specifically defined by several distinct practices (Barratt Brown, 1993; Nicholls and Opal, 2005):

- Direct purchasing from producers
- Transparent and long-term trading partnerships
- Co-operation not competition
- Agreed minimum prices to cover the costs of production, usually set ahead of market minimums
- Focus on development and technical assistance via the payment to suppliers of an agreed Social Premium (often 10% or more of the cost price of goods)
- Provision of market information
- Sustainable and environmentally responsible production

The Fairtrade label assures consumers that any certified product they buy conforms to these standards and is regularly audited as such. The connection between supermarket purchase and positive producer impact is thus underlined.

So why is Fairtrade needed at all?

## **What is 'Unfair' about Global Trade?**

Classical free trade theory has its origins in Adam Smith and David Ricardo's theories of comparative advantage (see, for example, Krugman and Obstfeld, 1997). Under the

theory of comparative advantage, countries export what they are relatively good at producing and import what they are not. Mountainous Guatemala grows high-quality, cloud-forest-grown coffee; Japan manufactures technologically advanced electronic products. Opening up countries to international trade allows Japanese electronics producers to import delicious coffee, and Guatemalan coffee farmers to access high-tech products. Under free trade, both parties are better off: international trade is thus a win-win situation in which everyone benefits.

The supporters of free trade insist that the unfettered movement of goods, services and finance between countries offers the most efficient model of transactional business. Inherent in this is the understanding that whilst some benefit, others will inevitably fail, but that this still works ultimately for the general good, weeding out weak and inefficient players.

Widespread attempts to liberalise world trade and bring the benefits of free trade to all countries began after the Second World War. In a time of reconstruction and reconciliation, the General Agreement on Tariffs and Trade (GATT) - set up under the auspices of the newly formed United Nations in 1948 – endeavoured to arbitrate between international trade disputes via a series of ‘rounds’ of negotiations to promote free trade and international deregulation (see Ransom, 2001). This opening up of trade rules was accompanied by structural adjustment lending to developing countries by the International Monetary Fund and World Bank from 1960-1980, which was often tied to trade liberalisation. During the 1980s, 42 countries received loans from the World Bank with the express purpose of reforming their trade regimes (Rodrik, 1992). These interventions often resulted in the closure of state boards that effectively protected small producers from the discriminating monopsony of middlemen.

The volume of international trade has increased significantly over the last thirty years, suggesting that the GATT and its successor, the World Trade Organization (WTO), have had a considerable impact on generating free trade around the world (Rugman, 2002). Total trade in 2000 was 22 times the level of 1950 (Ransom, 2001). However, simultaneously global inequality has also grown – the share of the world’s income distributed amongst the poorest 10 per cent fell by a quarter between 1988 and 1993 whilst the share going to the richest decile increased by 8 per cent (Dikhanov and Ward, 2001). By the late 1990s the poorest 20 per cent of the global population generated only 1 per cent of the global Gross Domestic Product, whilst the richest 20 per cent generated 86 per cent (Young and Welford, 2002).

Clearly, the benefits of increased free trade have not been evenly spread. At one level, this failure is macroeconomic. High levels of indebtedness cause countries to rely on export-intensive industries and exploit resources in the short-term, with minimal regard for long-term consequences. Colonial and development legacies have resulted in export earnings being highly concentrated in just a few, often primary commodity, industries, leaving countries’ national income exposed to world price fluctuations (Timberlake, 1985). Furthermore, corruption in many developing countries can result in a failure to distribute export income equitably (Collier and Gunning, 1994).

But macroeconomics does not fully explain the failure of trade liberalization to distribute wealth evenly. The key conditions on which classical and neo-liberal trade

theory are based are notably absent in rural agricultural societies in many developing countries. Perfect market information, perfect access to markets, access to credit, and an ability to switch production techniques and outputs in response to market information are fundamental assumptions which are fallacious in the context of agricultural producers and workers in many developing countries.

The absence of these microeconomic conditions can nullify or even reverse the potential gains to producers from trade. Whilst it may be that the theory that international trade is a win-win for all actors involved on a national level is broadly correct, nevertheless, within developing countries, market conditions are not such that producers can unambiguously be declared to be better off through trade. Agricultural producers in developing countries face several market imperfections that question the ability of trade to lift them out of poverty:

- *Lack of market access.* An export market free from importing-country interference through subsidies and tariffs may be considered 'free' and function well for exporters, but if primary commodity producers cannot access these functioning markets, due to their remoteness and lack of transport, the benefits of this free market cannot be realized for them. To access markets, small-scale producers often rely on middlemen, who can collude to ensure that there is no competition for producers' goods and thus no fair market price for them (Rice and McLean, 1999). Such middlemen typically extract monopsonic rents from producers that drive down prices below the marginal costs of production, thus also disrupting the balance of local labour supply between domestic, leisure, and employment
- *Imperfect information.* A fundamental necessity for the functioning of any free market is 'perfect information', implying that producers and traders have access to knowledge about market prices. Remote producers with no access to radio, newspapers, or telephones cannot access information about prices, and are at the mercy of the middlemen who come to their isolated farms.
- *Lack of access to financial markets.* Producers in developing countries have no access to income-smoothing devices like futures markets. A cocoa farmer living in a remote mountain village in Peru cannot call the London Coffee and Cocoa Exchange to lock in a set price for next year's harvest, because of communications difficulties and a lack of significant volume to trade. Peru's international cocoa exporters and the US's chocolate ice cream companies can and do use futures markets to stabilise the costs of goods. Thus the cocoa farmer is left completely exposed to world price fluctuations, when a perfectly functioning futures market exists to protect him or her from these variations. Similarly, such a farmer has no access to insurance cover to protect his or her income from weather or political risk.
- *Lack of access to credit.* Rural banks are either nonexistent or do not lend in the small amounts that family farmers require. Thus, credit for farm machines and fertilizers is often provided only by exploitative middlemen at extremely high rates of interest. Much as farmers are not able to access fair markets for their crops, they cannot access fair markets for credit.

- *Inability to switch to other sources of income generation.* In a perfectly functioning market, economic actors can switch easily from one income-generating activity to another in response to price information. This is clearly not the case for the world's poor. Even if isolated producers had access to price information, their ability to change their source of income is limited. Firstly, the 1.2 billion people who live on less than \$1 a day (IBRD, 2000) are extremely risk-averse. Switching from growing a crop that your grandfather grew to a higher-priced crop that no one in your village has ever grown is an extremely risky activity. For families with no slack in their income and little by way of savings, risk-taking is not an option. A lack of access to credit or education about other income sources contributes to this inability to diversify income sources (Oxfam America and TransFair USA, 2002).
- *Weak legal systems and enforcement of laws.* Many developing countries have passed strict environmental and labour laws that are ignored by local authorities. Factory owners may bribe local officials to overlook pollution and labour violations. Countries that do enforce laws may see investments move to more lax regimes. Farmers with insecure land title cannot use their land assets as collateral for loans to diversify into other areas of production, or invest in technology improvements on their farms (deSoto, 2000).

### **How Fairtrade Makes Markets Work Better**

One of the most important benefits of the Fairtrade model has nothing to do with the price floor and is thus perfectly compatible with a free market system: the requirement to work directly with producers, whether they are farming co-operatives, plantations, or small-scale craft manufacturers. Fairtrade importers must, wherever possible, buy directly from a farming co-operative, a farming estate, or local producer group. While estates, plantations, and large-scale farming groups have historically enjoyed access to export markets, small-scale producers are typically isolated from direct export access unless organized into co-operatives or similar group-selling structures.

The organization of small-scale producers into co-operatives or larger trading groups addresses several of the market failures outlined above. Simply improving the trading standards already increases producer income, by allowing them to capture more of the prevailing market price, even if they are unable to sell at the higher Fairtrade price. The major microeconomic market failures, and how the Fairtrade requirement to work with co-operatives addresses them, are outlined below.

#### *Lack of Access to Markets*

Under a co-operative structure, farmer members own shares in an umbrella business organization, with equity ownership usually proportional to the amount of product they sell through the co-operative. The co-operative can pool farmer resources to own or rent a truck, which is used to travel to members' farms to collect product. Because the co-operative is owned by the farmers themselves and all co-operative profits are shared democratically according to the wishes of the farmer members, there is no incentive for this market access component to be exploitative. Co-operative membership allows small farmers to benefit from group selling and

purchasing. Historically, only large estate owners and export companies who consolidated products from middlemen realized such benefits.

#### *Producers Lack Information about Prices*

Once organized into a co-operative, farmers can also pool their income to purchase a phone, fax, and Internet service to ensure access to current price information. Co-operatives can offer storage facilities and warehouse shelf-stable product during low-priced markets to protect themselves from market fluctuations, benefiting their farmer members by using information about future prices to control when they sell.

#### *Producers Lack Information about Quality and Industry Requirements*

The concept of perfect information applies to other elements of a business transaction besides price. Quality requirements and general industry knowledge are other important factors that change the value of a particular crop. However, small farmers with little direct market feedback or experience may not be able to capture such knowledge. If acting on their own, small farmers cannot interact directly with customers in the North to get feedback regarding quality and business capacity requirements. Language barriers are an obvious way that small farmers can fail to reach potential clients. By joining a large export co-operative, small farmers can pool resources to hire, for instance, an English- or German-speaking sales manager to better market their products.

The power differential that exists between small farmers and traders can often be easily addressed through farmer organisation and pooling of resources. Information disequilibria can be corrected with a very small investment, as is shown in the case of cocoa traded in West Africa. In Ghana, the government is the sole exporter of cocoa beans but buys beans from middlemen who consolidate product grown by small family cocoa farmers. These middlemen visit remote farms and bring scales with which to weigh the farmers' beans. With no capital to invest in their own scales, villagers are at the mercy of middlemen with rigged scales. Kuapa Kokoo, a cocoa farming co-operative in Ghana, used co-op funds to purchase scales for villagers to check the middlemen's calculations (Carslaw, 2002). A village-level investment of £100 for a scale thus protected the farmer members from this exploitative practice and farmers are enjoying a larger income from middlemen. Their ability to purchase accurate technology and the price information they gain through the co-operative has improved their bargaining position considerably.

#### *Producers Lack Access to Financial Markets*

Many commodity exchanges also trade futures and options, contracts that involve trading a commodity at a later date for a price fixed today. Since it makes their income predictable, farmers benefit from locking in a specific selling price for their crops at a future date (or an option to sell at a given price). However, accessing these income-smoothing market solutions is virtually impossible for small farmers. Futures contracts are for large amounts of products, several times more than small farmers' annual output. While a typical subsistence cocoa farm may yield only 1/2 ton per annum, futures contracts in cocoa beans on the London International Financial Futures and Options Exchange and the New York Board of Trade, are in units of 10

metric tons (International Trade Centre, 2001). Trust among parties on the exchanges is built through relationships and exchange memberships, involving registration with the exchange and, often, audits - something that is not possible for a small-scale farmer, but is easily done by an export co-operative. Pooling production through a Fair Trade co-operative thus allows all farmer members to benefit from these financial markets and reduce their exposure to risk from price fluctuations.

### *Credit Markets Are Not Competitive*

The Fairtrade standards recognize credit as a central issue for farmers with seasonal crops (especially coffee) who could benefit from loans out of the harvest season. As a result, one of the key Fairtrade requirements for such seasonal crops is that the importer must provide up to 60 per cent of the contract amount if asked by the co-operative. Credit is thus not guaranteed unless the seller requests it, and, unfortunately, anecdotal evidence suggests that sometimes co-operative leaders are afraid to ask Fairtrade importers for credit for fear that the buyer will go to a less-demanding co-operative and they will lose the sale.

### *Producers Cannot Easily Respond To Market Forces*

Even if the switching costs are low, poor producers can often be highly risk-averse, meaning that they avoid risk even if the potential rewards are extremely high. If a farmer is barely able to provide for his family's basic needs of food, clothing, and housing, he is going to be reluctant to switch to another income source with no proof of success. Farming non-organic cocoa beans may not have pulled his family out of poverty, but it may have always provided enough income for basic survival. But what if he were to stop using fertilizers, in order to gain organic certification, and his crop failed? His children might starve. The farmer is therefore extremely risk-averse: the threat of a possibly large loss of income outweighs any potential benefits. This risk aversion hampers the functioning of the free market by reducing the ability of actors to change behaviour in the face of market signals. The organic certification decision is a parallel for crop switching decisions faced by farmers all over the developing world; sugar farmers deciding whether to plant soy; coffee farmers deciding whether to plant cocoa and so on.

Risk aversion is, thus, a poverty problem. The main way that Fairtrade directly addresses this more subtle issue is through the guarantee of above-market prices, which raises the income of producers. As farmers get higher incomes, they have more room to manoeuvre and might consider trying out new income-generating activities. Improved market information can also build the producer's confidence.

Yet an interesting indirect benefit of Fairtrade is the increase in knowledge transfer and the demonstration effect as a result of the required organization of poor workers and producers. The Fairtrade standards require small farmers to be organized into co-operatives, and workers to form representative bodies, in order to distribute the Fairtrade premia. This increased organization results in faster and more codified (often documented) knowledge transfer. Representatives of central co-operative organizations visit several villages of member co-operatives and are exposed to successful projects that they can then share with other co-operative members through formalized communication channels. Farm workers can pool their Fairtrade resources

and start new joint business ventures, spreading the risk of failure among several members.

### *Weak Legal Systems*

Many developing countries have passed progressive wage and benefits laws, but rarely enforce them. The Fairtrade minimum price guarantee is intended to ensure that the seller is earning enough to cover wage costs. Furthermore, FLO Fairtrade standards require farms and co-operatives who employ significant numbers of workers to abide by International Labour Organisation standards and domestic laws regarding the use of child labour, the right to organize, the use of dangerous chemicals and machinery, working hours, and other fundamental labour rights. Fairtrade inspections verify that workers receive, at least, the country's legal minimum wage, or the local wage, whichever one is higher. The Fairtrade process is, thus, an independent verification of wage and labour standards that may exist but may not be enforced in producing countries.

### **Fairtrade Impacts**

The rapid growth of Fairtrade sales in Northern markets has transferred millions of dollars to disenfranchised producers in the developing world. Measuring the extra income earned by farmers through sales of Fairtrade certified products is fairly straightforward. The Fairtrade Labelling Organisations International (FLO) determines the income benefit of Fairtrade by calculating the difference between Fairtrade floor and market prices per Fairtrade product, and then multiplying by the volumes traded. In 2002, FLO estimated the income benefit to Fairtrade coffee, tea, cocoa, sugar, rice, fruit, honey, and juice producers at £21m, of which £17m was attributable to sales of Fairtrade certified coffee. Cafédirect alone returned £2.8m in additional income to its coffee suppliers in 2003. Furthermore, TransFair USA estimated that, in five years of activity in the USA, Fairtrade has returned over £16.8m to coffee farmers in developing countries above what they would have received in the conventional market (TransFair USA, 2004).

Yet extra income is just one of the benefits accrued to producers through Fairtrade, and may not even be the most important aspect to producers (Kocken, 2002). Fairtrade producers gain value from long-term relationships, direct trade, and credit provision, all of which help them in their non-Fairtrade sales negotiations. The communities in which Fairtrade producers operate benefit from development projects funded by Fairtrade co-operatives and farm worker organizations. Even self-esteem and confidence are improved as Fairtrade farmers identify with an international alternative trading movement. Organizations such as Traidcraft Exchange or the Day Chocolate Company have brought producers from the South into a more equal relationship with Northern businesses and markets. Such work has also produced powerfully positive social and economic externalities in terms of improved negotiating skills and community building.

Ronchi (2002) divided the impacts of Fairtrade into direct impacts on producers and their organizations (through increased income and credit provision), and the indirect impact that Fairtrade's support of co-operatives has on co-operative members, non-member producers, other co-operatives, and other organizations.

### *Direct Impacts*

Direct impacts of Fairtrade on producer groups include:

- Income (Fairtrade market premium and social premium)
- Education
- Female empowerment
- Preserving indigenous culture
- Psychological effects, such as producer empowerment and its effects on civic participation

It is not surprising that Fairtrade was found to have a positive impact on producer income levels. Whether or not the benefits of higher incomes trickle-across to all members of producer families remains to be seen – the anecdotal evidence of Fairtrade beneficiaries placing a priority on education would seem to indicate that children do benefit from higher Fairtrade incomes. Women may benefit from participating in Fairtrade production and women-oriented projects implemented by Fairtrade co-operatives, but because their workload may increase this benefit can be lessened. The evidence regarding Fairtrade support of indigenous cultures is limited, and the influence Fairtrade networks can have on these cultural factors, especially in agriculture, is most likely small. Fairtrade does seem to have positive effects on producer self-esteem and psychological health.

### *Indirect Impacts*

Indirect impacts of Fairtrade on producer groups include:

- Positive externalities which derive from support for co-operatives and progressive plantations
- Benefits accrued to Fairtrade groups through direct trade relationships

Impacts of Fairtrade on non-Fairtrade producers include:

- Access to market and price information
- Impacts on the broader communities where Fairtrade producers operate
- Isolation of non-Fairtrade producers

In working only with co-operatives and progressive plantations, Fairtrade has an indirect impact on producers by supporting groups that have other benefits for small farmers and farm workers. In the case of plantations, Fairtrade provides an internationally approved symbol of recognition for plantations that treat their workers well, as well as guaranteeing the export price required to meet labour standards and provide extra social premia to the workers. Co-operatives, while far from perfect, do appear to have beneficial effects on social capital development and civic participation. Fairtrade inspections and the certification process can help address their weaknesses. Finally, Fairtrade networks appear to benefit producers in their non-Fairtrade transactions through access to information and reputation enhancements by being involved with the Fairtrade movement.

## **Economic Objections to Fairtrade**

Despite its global success in the consumer market place, a number of neo-liberal economists have voiced objections to the Fairtrade model. For example, they argue that the use of a price floor in the Fairtrade model is a fundamental hindrance to the efficient functioning of the free market. By keeping prices high through the Fairtrade price floor mechanism, farmers and producers cannot sell their surplus bumper crop because there are not enough willing buyers at the high price. The result is wasted product that could have been sold had the price been allowed to be lower, known as a 'dead weight loss'

While it is true that a price floor imposed on the entire market can in theory lead to excess supply, the reality is that Fairtrade products account for at most 1 per cent of the trade in their particular markets. Thus, Fairtrade cannot be 'price-setting' because 99 per cent of world trade still operates under free market principles. Of course, as Fairtrade market share continues to grow, the price floor will eventually have some effect on the world market price and thus create distortions. As Fairtrade gains market share, it will be necessary for the Fairtrade system to change in order to be more flexible during supply shocks, perhaps even abandoning the price floor mechanism after reaching a certain market share. A further option may be to increase the sophistication of the price floor mechanism by offering different floors based on quality and origin. This would give buyers more options for offering Fairtrade labelled product whilst remaining competitive on price.

Moreover, as consumer awareness of the needs of subsistence producers grows it may be that demand curves will shift such that there is little demand for low-priced goods because consumers understand the negative implications for producers of paying low prices. In the Fairtrade market, this could already be the case in Switzerland, where by 2004 Fairtrade bananas had achieved a 50 per cent market share. In this scenario, the demand curve would be much flatter, and the dead weight loss created by a price floor much smaller.

It is also argued that a guaranteed high price encourages farmers to plant more and leads to a structural oversupply in agricultural markets. Again, because Fairtrade is such a minor part of global trade in commodities, it is unlikely that currently the price floor is sending a signal on an industry-wide level that would encourage farmers to plant more.

To some economists, then, Fairtrade is an aberration (see, for instance, Lindsey, 2004). Firstly, its price structure fails to obey the rules of a 'free market', setting price controls that are driven by humanitarian issues rather than the 'free' interaction of supply and demand. It is thus accused of fostering and, indeed, encouraging, uncompetitive production. Secondly, 'ethical' consumer behaviour is seen as highly 'irrational', since it does not aim to maximize the financial utility of the purchaser (Fairtrade products generally sell at a premium) and, thus, does not conform to conventional market mechanisms.

However, Fairtrade is a unique solution to market failures in the global trading system. Firstly, as a consumer choice movement, it is outside the scope of

government regulation and thus cannot be criticized as an interventionist trade policy. Secondly, by correcting market failures to make the trading system work for everyone, Fairtrade is, in fact, a neo-liberal solution to problems with trade. Fairtrade works within an efficient capitalist system, rather than abandoning the liberal trade model entirely (Jones, 2004).

### **Integrity of Fairtrade Standards**

Recently a number of competing 'ethical' labels have emerged to challenge Fairtrade certification in such product groups as coffee and tea. The most high-profile examples include the Rain Forest Alliance, Utz Kapeh (at Ahold supermarkets), and the Common Code for Coffee. However, it is important that consumers realise that these labels are not analogous with Fairtrade and that the latter is the only market-driven mechanism that offers real positive impacts for disenfranchised producers. Of particular significance are three unique features of Fairtrade.

#### *Long-Term Trading Relationships*

The requirement of Fairtrade importers to sign long-term contracts is another way to smooth income and correct information failures. By locking in prices, farmers benefit from a predictable income flow, much like a futures market. Strong relationships with buyers encourage information exchanges regarding quality and logistical requirements that farmers whose product is sold on the 'faceless' commodities exchanges cannot enjoy. Direct trade and long-term buying contracts help farmers increase the amount of the export price that is returned to them as well as allowing farmers to access market information.

#### *Floor Price*

The Fairtrade minimum price is always either the market price or the Fairtrade floor, whichever is higher. The Fairtrade floor price is intended to cover the costs of production and is loosely structured on the following formula:

Fairtrade floor price = cost of production + cost of living + cost of complying with Fairtrade standards (costs of certification/renewal costs)

Costs of production and living are usually calculated individually for each country of origin or region (e.g. Africa, Central America). Costs of production are intended to cover land, labour and capital costs of sustainable production and are calculated based on surveys of producers; an extra premium for certified organic production is included to cover the extra costs of investing in transitioning to organic production and organic certification. The cost of living element is intended to ensure Fairtrade producers a decent standard of living, estimated through proxies such as real interest rates and daily or minimum wages. Costs of complying with Fairtrade standards include, for instance, the costs of belonging to a co-operative, costs of organizing a workers' assembly, paperwork associated with inspections and reporting to FLO, attending world and regional Fairtrade assembly meetings, etc. While some attempt is made to accommodate regional differences in cost of living and costs of production, in the interest of simplicity averages must be taken. For example, the Fairtrade floor price for Nicaraguan coffee is the same as for Costa Rican, despite the fact that Costa

Rica's cost of living is much higher – GDP in Costa Rica is four times higher in terms of purchasing power than in Nicaragua (CIA 2004).

For commodity farmer members of co-operatives, the Fairtrade floor price can be considered the equivalent of a minimum wage. It is intended to provide farmers with a sufficient income to cover their costs of production and provide for their families. For estate owners who hire labour to work on their farms, the Fairtrade floor price is considered enough to pay workers the minimum wage or the local wage (whichever is higher) and provide decent working conditions. The Fairtrade standards for hired labour require that International Labour Organisation minimum labour standards are met regarding pay, worker safety, etc., and the standards ensure that this is possible through a guaranteed minimum price.

### *Social Premium*

In addition to the Fairtrade minimum price, Fairtrade standards require the payment of a social premium to the co-operative or farm worker organization. The social premium is added regardless of organic or quality product features and must be spent by the co-operative or farm worker organization on social development projects in the grower community. FLO inspections check that the social premium was earmarked for and spent on social development projects chosen by the community. This social premium is a fundamental aspect of Fairtrade pricing and is the essence of using Fairtrade as a business-oriented development strategy.

If the fair price is to be compared with a minimum wage scheme, one can translate the social premium to a savings rate component of a minimum wage calculation. To simply cover the costs of living and production with compensation does not allow those living on minimum wages to invest in retirement, or health care, or education; in other words, they must be completely dependent on government or community support for all savings and investment in bettering their lives. In developing countries in particular, the government is often poor at delivering these services, and local communities often do not have the resources. The Fairtrade social premium, therefore, is the guarantee that producers earn a little extra to invest in improving their social condition or the quality of their natural environment. In fact, Fairtrade co-operatives and worker organizations must jointly decide on projects to be funded with the social premium and demonstrate to inspectors the progress on such projects and how they benefit the community. Including a social premium in the calculation of the minimum Fairtrade price could be explained as a way to ensure a savings rate among farming communities.

### **Conclusion**

Arising out of a perceived failure of liberalized international trade to bring benefits to the most disenfranchised producers in developing countries, Fairtrade is rapidly becoming the consumer standard for social responsibility in the sourcing of agricultural commodity products. Because Fairtrade is entirely a consumer choice model, it operates within the larger free trade model of unregulated international commerce. Fairtrade is not controlled or enforced by any government agency; rather it can be seen as just another product feature, like colour or size, albeit a very powerful one. Economists shy away from floor prices, but if consumers are willing to

pay more for the Fairtrade guarantee of giving farmers a higher price, it is, clearly, their right to do so. Fairtrade actually increases the options and choices available to consumers, one of the key benefits of capitalistic systems.

Fairtrade also makes the free trade system work the way it is supposed to. By providing farmers access to credit and information, it corrects market imperfections. As with any market, the more knowledgeable one's trading partner, the more they are likely to gain in a negotiation. Transferring market knowledge to developing-country producers will inevitably make them better off. So there are some losers in Fairtrade, namely brokers and middlemen, who had been relying on one-sided information flow and exploitation of farmers. But on balance, all actors within a free trade system should benefit from the increases in transparency, efficiency, and competitiveness that come from Fairtrade's expansion of the market power and knowledge base of primary producers.

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